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UNCLAS SECTION 01 OF 02 LILONGWE 001013

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E.O. 12958: N/A
TAGS: ECON ENRG EINV EPET EFIN PGOV MI
SUBJECT: MALAWI HIKES FUEL PRICES, BUT NOT ENOUGH

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SUMMARY

¶1. (SBU) The Government of Malawi has recently raised retail fuel prices for the first time since March 2004. The increase amounts to 8.9 percent on gasoline and diesel, reflecting only about half of the increase in world petroleum prices during the past six months. The increase, which is expected to have immediate inflationary implications, comes at a time of increasing inflationary pressure in Malawi. Whereas the inflation of a full price pass-through could derail Malawi's IMF staff-monitored program, interference in the pricing mechanism may be of concern during the upcoming IMF staff visit. End summary.

A MODEST INCREASE, LONG DELAYED

¶2. (U) On October 22, the GoM raised retail fuel prices by 8.9 percent, the first price increase since last March. Prices went from MK94.30 to MK102.70 ($0.88 to $0.96) per liter for gasoline and from MK87.60 to MK95.40 ($0.82 to $0.89) for diesel. An increase had been recommended by the Petroleum Control Commission (PCC) since April, but for political reasons, former President Bakili Muluzi had quashed adjustments in the run-up to May elections. The new administration of President Bingu wa Mutharika had not addressed the issue since its assumption of office at the end of May and indeed had promised within the past month that prices would not be raised.

¶3. (SBU) As a result of increases in world fuel prices, the government-controlled consortium of private fuel importers, Petroleum Importers Ltd. (PIL), was facing potential losses of MK 30-40 million ($280,000 - $374,000) per month, according to one member of the consortium. (NOTE: PIL includes two U.S. business interests: ExxonMobil and Caltex. End Note.) PIL had not yet reached a crisis, largely because the retail price includes levies for price stabilization and for reimbursing PIL when prices are not adjusted quickly enough. However, the price stabilization fund, which is designed to smooth out short-term spikes in world prices, was on its way to exhaustion before the end of October. At that point, PIL would have had to cut back on import volumes, causing fuel shortages.

INFLATIONARY REALITIES

¶4. (SBU) On October 5, the PCC had recommended that gasoline be increased to MK108 and diesel to MK102. These prices would have reflected world increases (estimated locally at 17-20 percent), but they would also have brought inflationary pressure to bear on the Malawian economy. Because of Malawi's reliance on overland imports, and disproportionately on fuel-inefficient trucking, the inflationary impact of fuel price hikes is rapid and widespread. This fact is intensified by timing: the spring and summer here (October to March) are the high season for inflation, due to seasonality in agricultural input and food prices. And any inflation above 20 percent would put Malawi off-track for its IMF staff-monitored program.

¶5. (SBU) For understandable reasons, then, the Government chose not to unleash the PCC's automatic pricing mechanism, which is designed to pass through sharp increases in world prices (greater than 5 percent). Instead, GoM has simply increased the levy that reimburses the importers for import losses caused by artificially low prices. In essence, this allows the importers (PIL) to recover most of their losses

directly, while sparing the public the collateral increases that an adjustment in the base price would entail (through percentage-based increases in other levies and profit margin).

COMMENT: A SENSIBLE MIDDLE COURSE?

¶6. (SBU) While the 8.9 percent price hike may seem a sensible middle course between an inflationary full-price adjustment and popular but irresponsible inaction, there are some downsides to this course. First, it suppresses the PCC's automatic pricing mechanism, which continues Muluzi's practice of tinkering with the pricing and levy structure to meet the exigencies of the day. If full adjustment follows next year, after inflationary pressures have subsided, the GOM's solution may be viewed as a wise interim measure. On the other hand, if the Kwacha is devalued, or if an inflationary cycle picks up for other reasons, full adjustment may be put off, leading to a bigger shock later. Second, industry sources tell us that Malawi's low retail prices are driving some informal exports, which could result in shortages.

¶7. (SBU) Finally, and perhaps most importantly, it is unclear at this juncture how the IMF will view continued suspension of PCC's automatic pricing mechanism. Its proper functioning was a required prior action for previous IMF facilities, and IMF's November staff visit could highlight this as a recurring problem. In our view, it is more likely the IMF will see the partial adjustment as an understandable effort to avoid both fuel shortages and inflationary price shock.

GILMOUR